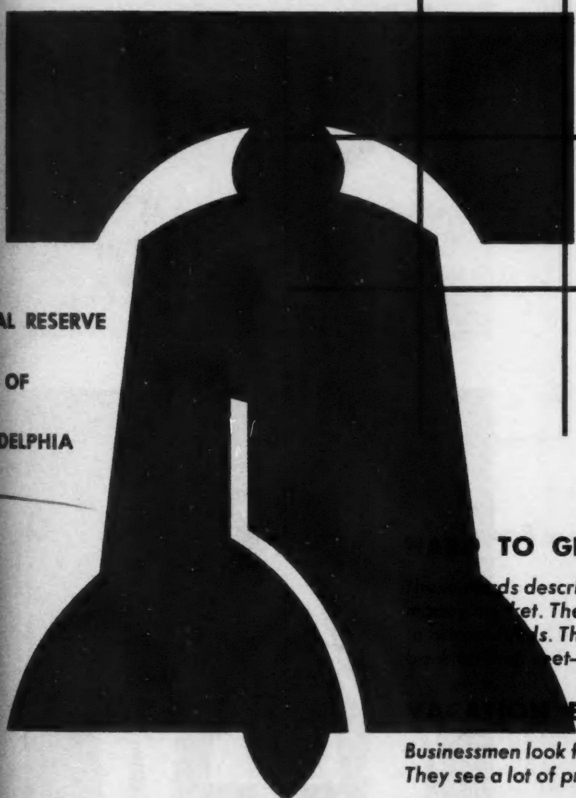
MONEY

LY 1957

business review



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TO GET

ds describe FHA and VA mortgages in today's ket. Their sticky interest rates make it difficult for them s. There are many plans to put the two programs et—but the solution isn't clear-cut.

BUSINESS

Businessmen look for a good year at Third District summer resorts. They see a lot of promise in early-season spending patterns.

CURRENT TRENDS

In the broad sense business is behaving pretty much as predicted.

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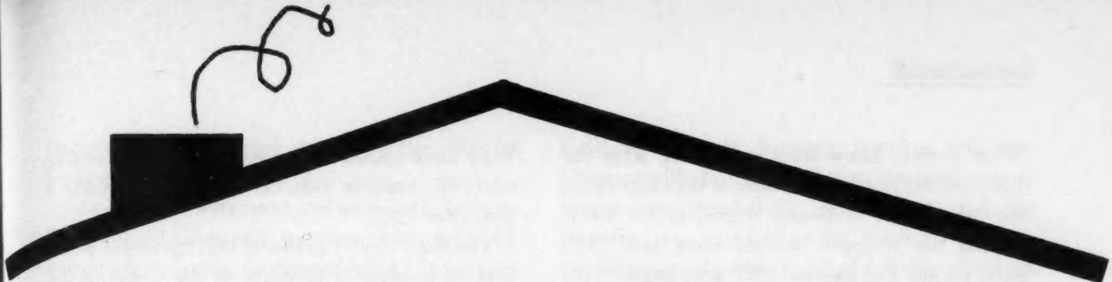
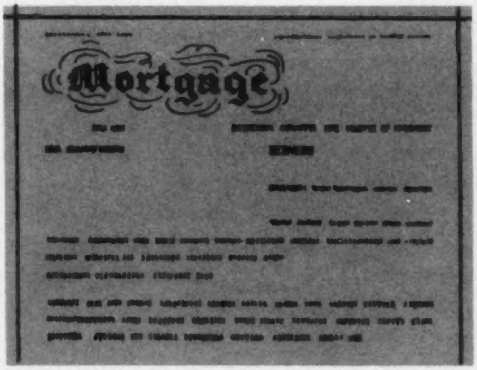
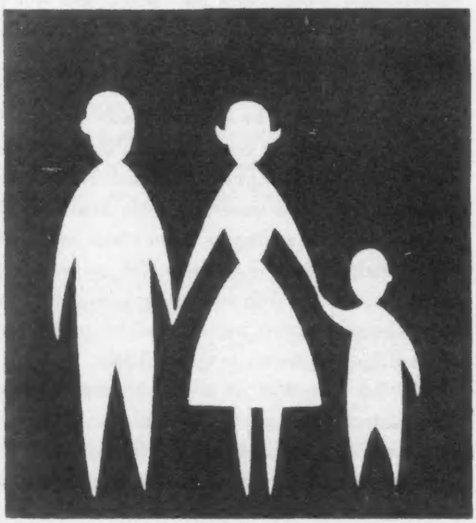


HARD TO GET

FHA and VA Mortgages in Today's Money Market





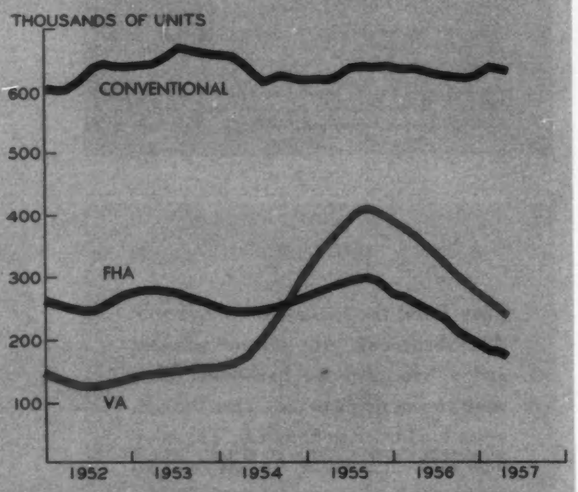
They loved the house—split-level with three bedrooms, big picture window, and a fine yard for barbecues. They were almost ready to buy. Then the conversation turned to financing. The salesman said: "I'm sorry, we just can't arrange a G.I. mortgage for you. They're awfully hard to get these days. Now, if you could only manage a conventional down payment. . . ."

This little sample-house drama has been enacted many times in recent months. Many builders no longer sell "VA financed" homes, and banks and other lenders are reluctant to make loans on VA terms.

House hunters know from experience what statistics tell the rest of us. A look at the chart shows that the number of houses started under VA financing has dropped sharply since late 1955. Starts for the first quarter 1957 were down 45 per cent from a year ago.

NEW HOUSES STARTED

Privately owned nonfarm dwelling units by type of financing (12-month moving totals).



Source: Housing and Home Finance Agency

The pace of the FHA's home-mortgage program also has slowed significantly.* FHA starts have declined for a year and a half. They did not rise as high as VA starts in 1955, however, nor have they fallen quite as far or as fast.

On the other hand, conventional starts without Government backing have hardly slipped at all. They have shown much more stability, ranging narrowly between 600,000 and 700,000 units a year since 1951.

The chart clearly indicates that the recent weakness in housing is centered in the Government-backed sector of the market. There is a good reason for this. But before we discuss the current situation it might be well to look into the past to see how the programs started and what they were supposed to do.

PERSPECTIVE OF HISTORY

The Government's mortgage activities began during the depression when the housing sector, like the rest of the economy, was in pretty bad shape. Many mortgages were in default. Unemployed borrowers, saddled with stiff payments contracted in the 1920's were in danger of losing their homes. Hardly anybody could afford a new house, and building activity was at a stand-still.

Housing was sick and the Government prescribed some effective medicine. Early action was in the nature of first aid for homeowners. The Government bought defaulted mortgages and rewrote them on easier terms, terms that could be met out of reduced incomes.

Then the Government's emphasis turned from relief to recovery. The economy badly needed the kind of push that a resurgent building industry could give. But building wasn't able to do much pushing. Men and materials were available but equally essential mortgage money was not. Lenders, already singed by defaults, did not want anything more to do with real-estate loans and most would-be mortgagors were unable to qualify for, or unwilling to take on, additional debt.

In 1934, Congress set up the Federal Housing Administration whose job it would be to get private funds flowing back into mortgages. The FHA went about its task with a two-pronged program.

* Though the FHA has several types of mortgage programs, this article is concerned only with the major one for privately owned homes—Title II, Sec. 203.

One prong was directed at lenders, the other at borrowers.

For lenders, who were holding back because they thought mortgages were too risky, the FHA undertook to make mortgages safer. It insured good loans against default, saying in effect that it would repay if the borrower could not.

For borrowers, the FHA innovated easier terms. Perhaps "more realistic" would be a better description because the new terms were designed not only to attract borrowers but to make mortgages safer investments by making them easier to repay. The FHA agreed to insure mortgages with longer maturities and lower down payments than were available at the time. It also insisted that eligible mortgages bear a more moderate rate of interest and that they be paid off in regular instalments.

Thus the FHA came into being as an emergency measure designed to lift housing out of the depression. At first it was considered a temporary stimulus, but it caught on so well that it has become a permanent part of the market structure.

The Veterans Administration's mortgage program also was created in time of crisis. It came to life in 1944 as part of the famous "G.I. Bill of Rights." The general objective, as stated in the bill itself, was to provide "aid for the readjustment in civilian life of returning World War II veterans." The program also had a practical economic purpose. Congress hoped that it would solve the already brewing housing shortage. Cities, unable to expand due to wartime restrictions, were jammed by war workers and the crowding was expected to get much worse when the veterans returned. A lot of low-priced homes would be needed in a hurry.

By guaranteeing a part of the veteran's mortgage, the VA hoped to generate the necessary post-war building. The idea was essentially the same as the FHA's, that is, reduce risk and make borrowing easier. The guaranteed part of the loan—at first $2,000 or 50 per cent, whichever was less—would take the place of the veteran's equity and make it possible for him to buy with no down payment at all.

Congress passed another G.I. bill in 1952, extending much the same rights to veterans of the Korean conflict. It was more a matter of equity this time for the housing shortage had begun to ease.

Unlike its FHA counterpart, the VA program still is a temporary one. Men and women now entering the service are not eligible and definite expiration dates have been set—July 1958 for the World War II veterans and January 1965 for those who served in Korea.

TYPICAL MORTGAGE TERMS THEN AND NOW

	In the 1920's	FHA & VA Today
Maturities	3-10 years	25-30 years
Down payments	30-50% purchase price	10-20% purchase price
Interest rates	6-8% and higher	4½-5%
Repayment method	Often lump sum at maturity	Monthly
Second mortgages	Very common	Not permitted

FHA AND VA TODAY

Our excursion into history should emphasize one point. The Government does not provide the money for FHA-VA mortgages. That money must come from private sources, and insurance and guarantees serve to stimulate its flow.

The Government does not give its backing indiscriminately. The prospective borrower and the property are required to meet basic standards. The terms of the mortgage itself—maturity, down payment, interest rate, etc.—also are subject to certain limits.

These are permissive standards; they operate

as minimums and maximums, not as fixed requirements. The actual terms are agreed upon between the borrower and the lender, subject to the Government's limits.

The limit on interest rates is an important factor behind the recent drop in housing starts. The maximum rates on FHA and VA mortgages are now set at 5 and 4.5 per cent, respectively. Except for FHA's boost to 5 per cent last December, these rates have not changed during the past four years. Most other rates in the capital market, on the other hand, have been rising recently, making competing investments more attractive.

Mortgages also require relatively costly servicing, and this puts them at a further disadvantage in the competition for funds. The lender has to handle escrow accounts for insurance and taxes, receive and record monthly payments, inspect the property, and so on. A good bond, in comparison, needs only to have its coupons clipped.

In the current "tight-money" situation there is not enough money for everybody who would like to borrow. Since lenders are in business for a profit, they naturally tend to put their available funds where they earn the most, consistent with safety and liquidity. They have found more profitable opportunities and have drifted away from the relatively low-yielding Government backed mortgages, especially the 4.5 per cent VA's.

Suppose you were a lender, a bank for instance. Suppose you had enough money to do all but one of the following: make a loan to a businessman at 6 per cent interest, lend an individual money to buy a car and get an even greater return, buy a corporate bond yielding 5 per cent, or invest in a 4.5 per cent VA mortgage. You probably would pass up the mortgage.

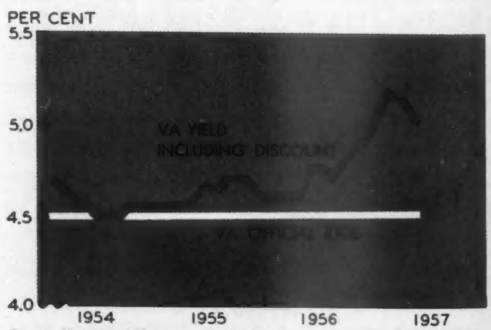
Yet the fact is that almost 26,000 houses—a sharply reduced but still substantial number—were started with Government backing in April. Much of this money probably was attracted by a device known as discounting. Discounts are a way of raising the yield or income to the lender without raising the nominal rate.

This is how they work. Let's say the borrower signs for a mortgage of $10,000. He agrees to pay the maximum VA interest rate on this $10,000 and to repay $10,000 over the years. But in order to make the return competitive with other lending opportunities the lender decides he will give only $9,000 for the $10,000 mortgage. In other words, he requires a discount from the regular price. This $1,000 discount, when spread over the life of the mortgage, helps to make up the difference between the VA rate and competing market rates. For example, a 10 per cent discount on a 25-year mortgage brings the yield from 4.50 to 5.56 per cent. If the mortgage is paid off before maturity, and mortgages often are, the yield is still higher.

Discounts do not really solve the fixed-rate problem, though, because it is difficult to find someone to pay the discount. The borrower cer-

HOW DISCOUNTS HAVE RAISED THE YIELD ON VA MORTGAGES

Computed from discounts on 25-year, minimum down payment, VA mortgages in the Philadelphia market.



Source: House and Home

tainly doesn't want to have to repay $10,000 and only get $9,000 towards his purchase price. Furthermore, the VA says that veteran buyers may not pay discounts. So that leaves it to the builder or, for second-hand homes, the seller. Since neither is anxious to reduce his receipts by the amount of a big discount, he often tries to sell on a conventional basis, where interest rates are not limited and discounts are unnecessary.

The builder or seller may attempt to pass on the discount to the buyer by raising the price of the house but this, too, is difficult because of FHA and VA regulations.

NO LACK OF SUGGESTIONS

What to do about the programs? There seem to be as many suggestions as there are "experts," and there is little clear-cut agreement among them. Here are some of the proposed plans.

Two points of view

Some people support the status quo. They want to keep things as they are, feeling that fluctuations in mortgage activity may actually contribute to the stability of the economy as a whole.

They think it is a good thing that, because of fixed rates, FHA-VA mortgages lose some of their ability to attract money when business is booming. This tends to lessen the total availability of credit at a time when inflation is a danger. But when some slack creeps into the economy and market rates fall, FHA-VA mortgages, their rates still unchanged, grow attractive by comparison. They become a profitable outlet for lender's funds.

By making FHA-VA mortgage credit less available in boom times, fixed interest rates serve to defer some expenditures on housing from times when they would be inflationary to periods of some slack when they might contribute to recovery.

At the other end of the scale are those who say: "Abandon both programs. They were set up under conditions that have long since changed and are no longer necessary." These critics believe that housing should fend for itself, at least in normal times. They think that the industry now is capable of operating without Government aid and that the nation can adequately house itself with conventional mortgages.

Mechanical changes

Between the positions of no changes and no programs lies a large number of remedial plans designed to alter the programs in one way or another for smoother operation.

One group says if low rates are keeping money out of Government mortgages, just raise the rates. Raise them and keep them in line with the market thereafter. They point to the FHA's boost from 4.5 to 5 per cent last December. The increase hasn't completely restored the flow of funds to FHA mortgages but it does seem to be making money somewhat more available. So why not raise the VA rate too?

In reply, it is explained that even this solution is not cut and dried. Unlike the FHA, the VA must have Congressional approval before it can raise the rates. Higher rates mean, of course, that the veteran himself must pay more, and Congress has been reluctant to agree to an increase.

A more subtle reason has been mentioned to keep the VA rate where it is. The World War II part of the program is due to expire next year, and more than 10 million veterans are still eligible. If VA mortgages were easy to get, these vets could bid the price of housing almost out of sight as they rushed to buy before the deadline.

Other proposals have been worked out to make more VA mortgages available without raising their rates. One plan is to put National Service

Life Insurance reserves into VA mortgages instead of the Government bonds in which they are now invested. Another is to have the VA make more direct loans to veterans. (It has limited power to do this now but seldom does.) A third idea proposes to increase the Government's operations in the secondary mortgage market. It would give the Government more money to buy old VA mortgages from the original lenders, freeing them to reinvest in new ones.

These three measures would probably ease the mortgage market, but they would do it with Government funds for the most part, their critics point out. Thus, they would either add to an already heavy tax burden or require additional borrowing by the Government at a time when it would increase existing pressures in the securities market.

Then there are those who think the demand for housing needs stimulation, that the number of

HOW THE TWO HOME MORTGAGE PROGRAMS COMPARE

	FHA (Title II, Sec. 203)	VA (Sec. 501)
What they do	Insure mortgage loans for ½% premium paid by borrower.	Guarantee mortgage loans at no cost to lender or borrower.
Who is eligible	Anyone who meets credit requirements. Program may be used more than once.	Veterans of World War II and Korea—generally limited to one mortgage. Also must meet credit requirements.
Type of house	One- to four-family dwellings. Must meet construction standards.	Owner-occupied residential dwelling. Must meet construction standards.
Limit to backing	Mortgage insured 100% with a limit of $20,000 on one-family units, up to $35,000 on four-family units.	Guarantee of 60% of purchase price but not more than $7,500.
On default	Unpaid balance of loan is covered. Lender forecloses and may transfer Title to FHA in exchange for debentures.	VA pays guarantee (amount reduced in proportion to reduction of original loan) and lets lender keep title—or it makes a cash settlement for outstanding loan balance and takes the property.
Maximum maturity	Thirty years.	Thirty years.
Minimum down payment	5% on first $9,000. 25% on balance of purchase price.	2% of purchase price.
Maximum interest rate	5% per annum. (Does not include ½% insurance premium.)	4½% per annum.

starts has declined because fewer people want to buy. They advocate easier terms on Government mortgages, especially lower down payments, to attract more buyers. But, other experts say, the limits on terms are permissive. Very few lenders even now will go the limit, and it is unlikely that borrowers would ever actually see any further liberalization.

Increase the money supply?

There is a faction that advocates creating more money. Just increase the supply of lendable funds and FHA-VA mortgages will get all they need, fixed rates or no, they say. The opponents of this course are quick to explain that the economy already has about as much money and credit as it can take without serious inflation. Any more spending power would not increase the supply of goods and services but would only raise their prices. Houses would cost more and offset the increased availability of mortgage money. Besides, they say, the widespread social hardships that go with inflation rule out its use to stimulate any one sector of the economy.

In summary, all the proposals seem to have their advantages and disadvantages. They attack the problem in different ways and promise different results. However, none of the plans to provide more funds for mortgages offers a way around the basic fact that if you are to bestow monetary favors on certain groups in times of full employment, you must do so at the expense of others. If somebody is to get more, somebody else is bound to get less—either by having less money to borrow for other purposes or less purchasing power because of rising prices.

VACATION BUSINESS

A preview of the 1957 season

Landlords and merchants at seashore and mountain resorts in the Philadelphia Federal Reserve District think vacation business will be "big business" again this year, with volume maybe a little higher than in the 1956 season. To be sure, firm predictions are an impossibility at this early date because so much depends on the weather. Nevertheless, most of those who compete for a share of the vacation dollars spent in the weeks between Memorial Day and Labor Day see a great deal of promise on the basis of this year's early-season activity.

June appears to have been a very good month in most places—much better than a year ago when vacation business was slow getting started. A warm July, such as the weatherman now predicts, offers another source of encouragement. It could "make" this season. But another cool month like July 1956 would have serious repercussions, especially at shore points where so much depends on a succession of warm, sunny weekends. Finally, there is August with its partiality for kicking up nasty coastal storms. At this early date, that month remains nothing more than a big question mark.

Advance registrations were heavy

Plans for a 1957 vacation seem to have matured earlier for more people than was the case last season. Many shore and mountain resort areas were reporting heavy bookings for July soon after the traditional "kick off date," which is Memorial Day. Early-season weather patterns appear to have played an important role this year. Initially, a whole string of pleasant weekends served as repeated reminders that vacation time was approaching. But it was the heat wave in mid-June that convinced so many people that it was time to find an appropriate spot in which to spend that "once a year" leisure period everyone looks forward to. Before the hot spell ended, some of our shore points were reporting the arrival of vacationers all packed to stay for a while.

Reservation periods haven't changed much

Although vacation time allowances have become increasingly liberal in the past several years, spending patterns and length of stay in any one place have not changed significantly. Flexibility seems to keynote the vacation plans of most people. Their budgets seldom call for more than a one- or two-week spending spree in any single resort. In fact, there seems to be a growing tendency for vacationers to make shorter stopovers and to stop over in more places. The rapid growth of motels in and near so many of our summer playgrounds doubtless has been an important factor in determining length of stay. This type of first-class accommodation has become especially attractive for those who want to "cover ground" during their holiday. But it also is finding increasing favor with the vacationers who just want to "get away for a while."

Motel business has expanded rapidly

In 1956, and again this year, new motels have been going up in places where cottage building formerly accounted for the bulk of residential construction. And at both seashore and mountain resorts the motels are said to be getting their full share of an expanding vacation business. Although the popularity of these roadside hostelries seems to be increasing by leaps and bounds, neither the hotels nor rental cottages have been experiencing any serious losses in patronage. For the month of July, at least, there appears to be enough vacation business to go around. And, unless the weather acts up, the same should be true for August. When motel building was making its debut at the seashore, many local businessmen were fearful of the impact on established accommodations, particularly the cottages and small apartments. So it was with some reluctance that ordinances were passed or revised to permit motel construction. As it has turned out, the motels in many of these places must be given credit for bringing an increasing flow of summertime guests, particularly over weekends.

Rates and rentals continue firm

Except for the usual early-season reductions and those customarily made after Labor Day, neither hotel rates nor cottage and apartment rentals seem likely to change this year. In the newer motels, rate structures are comparable with other types of first-class accommodations. With a smaller over-all volume of residential building this year, and what appears to be an increasing number of summer guests, there seems little possibility of any significant downward pressures on rates anywhere in our Third District vacation areas. But, of course, this picture could change swiftly with a

spell of bad weather to keep weekenders at home or chase away vacationers ahead of their schedules.

Retailers are well satisfied

Early-season business—mostly on weekends—has compared very favorably with last year's sales. Boardwalk shops and small-town merchants in the Poconos and other mountain vacation spots report a steadily growing volume since Memorial Day. Now, with more longer-staying guests arriving and the peak sales period at hand, storekeepers, restaurant owners, and those who operate amusement facilities appear optimistic for the coming season. Thus far the restaurant business has been called excellent. In most places prices are a little higher this season than last. But patronage has been increasing steadily and spending patterns for food and other refreshments are said to be similar to those of a year ago. In the area of amusements, there has been much concern over the New Jersey ruling outlawing so-called "games of chance." It was felt that shore-resort business volume must surely suffer this year. However, other forms of entertainment have been devised and the consensus now is that loss of resort revenue from games declared illegal will not be serious.

FOURTH OF JULY WEEKEND

The summer's first "big weekend"—July 4—launched this season's peak vacation period in a convincing way. For some people it was a four-day holiday, against only a mid-week break in 1956. Vacation business also was boosted sharply by the arrival of longer-staying guests taking up the reservations made in May and June before the schools had closed. As we go to press, reports from businessmen and bankers in Third District vacation spots indicate that spending for lodging, food, and amusement measured up to and, in some cases, exceeded earlier expectations.

CURRENT TRENDS

A Mid-Year Look at Business Activity

The half-way point for the year is behind us. All of the mid-year figures haven't been registered as yet, but it's about that time when business forecasters take a look around them to see if the totals are shaping up as projected.

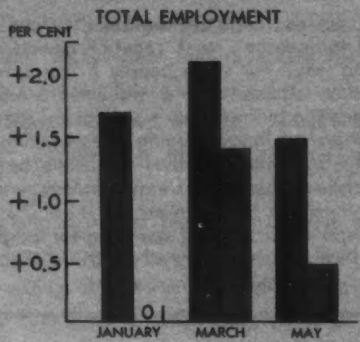
Some readers may remember that in December 1956 the *Business Review* of the Federal Reserve Bank of Philadelphia made its annual forecast for 1957. At that time the Review looked for G.N.P. to be about $20 billion higher than the total for 1956. This projection was somewhat higher than many other forecasts.

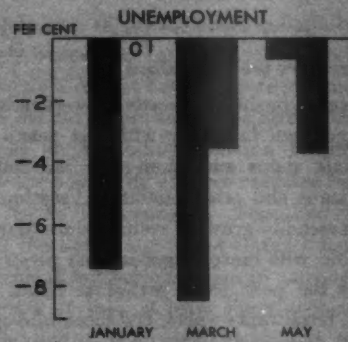
In 1956 G.N.P. was about $412 billion. By the final quarter of that year spending totaled $424 billion on a seasonally adjusted annual basis. On this basis, G.N.P. was $427 billion in the first quarter of 1957 and about $430.5 billion in the second quarter.

EMPLOYMENT TRENDS

Percentage change from year ago

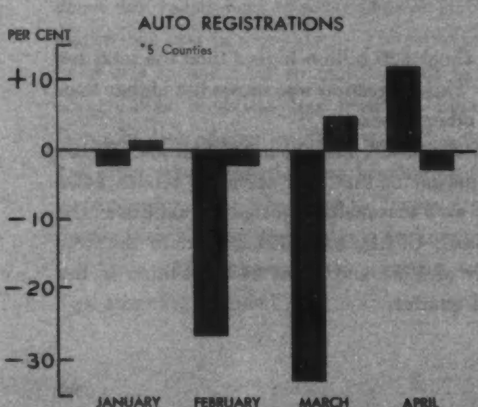
PHILADELPHIA*
UNITED STATES

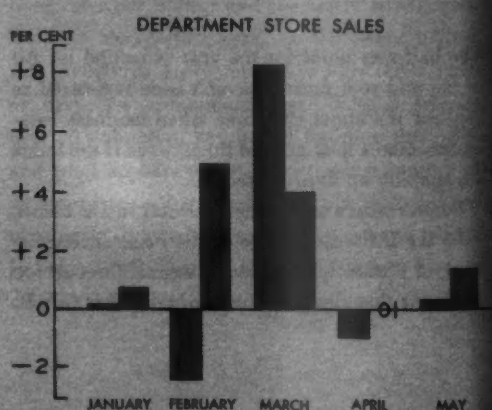




RETAIL TRADE TRENDS

Percentage change from year ago





These totals suggest that in the broadest sense the economy is performing pretty much as projected back in December. For example, if the rate of growth in the first half of the year carries into the second half, G.N.P. for the year would total just about $432 billion in 1957 or $20 billion higher than in 1956.

Looking within this broad measure the surprises are not many. Government spending has been very strong, as projected. If anything, it has been somewhat higher than expected. Businessmen have liquidated some inventory so far this year. If this liquidation persists it would constitute a mild surprise. Business spending on plant and equipment has been proceeding almost exactly as expected. Consumer spending, too, is holding very close to what was anticipated.

The almost docile behavior of business activity in the first half of this year makes predicting the second half hazardous indeed. On the other hand, a total spending figure of about $432 billion looks a lot more possible in July than it did last December. So we'll stick with that prediction and say that the second half of the year may show about the same rate of growth as the first half.

The Philadelphia Area

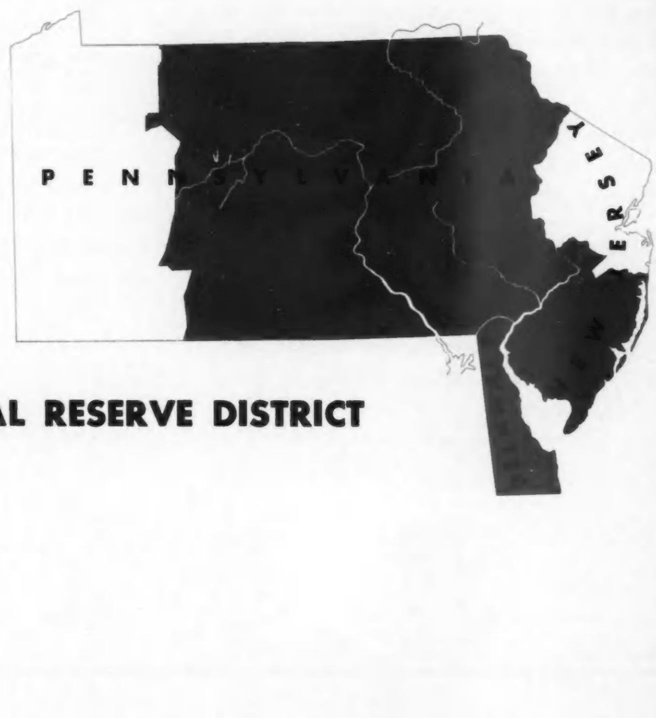
Business activity in the Philadelphia Metropolitan Area has lagged behind the rest of the nation for the past few years. However, over the first half of 1957 this situation may have reversed itself. We say "may have" because no over-all measure of business activity—such as Gross National Product—exists for the Philadelphia area. It is possible only to look at various "snapshots" of the business scene.

Certainly employment and unemployment behaved better in this area than for the rest of the nation in the first part of 1957. The chart shows the changes in employment and unemployment as compared with a year ago for January, March, and May. In the Philadelphia area, employment rose faster and unemployment showed more decline. Still, unemployment remains a relatively larger part of the work force in Philadelphia (5.6%) than in the nation (3.7%).

It is very heartening that after about three years of decline, manufacturing employment is bouncing back in this area. The chart shows the record of pluses here as compared with the more moderate changes nationally. Non-electrical machinery makers and apparel manufacturers have led the year-to-year gains.

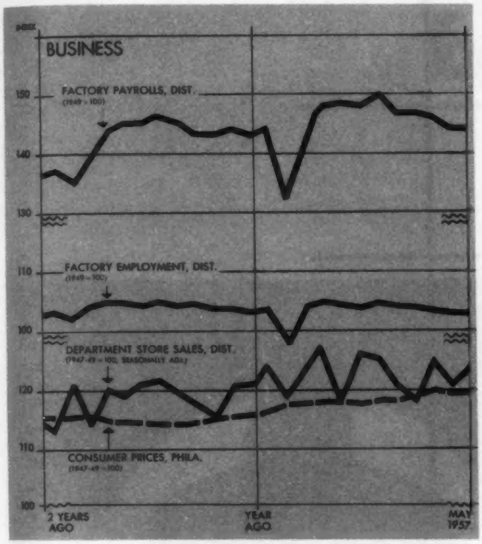
On the other hand, retail trade, as reflected by department store sales and automobile registrations, has not been going as well in the Philadelphia area. The charts show the story month by month. As can be seen, sales figures of local department stores and automobile dealers generally have lagged behind national totals.

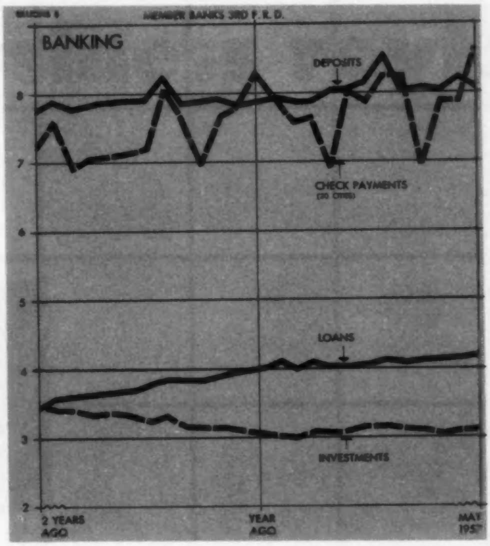
It is difficult to predict what will happen to the Philadelphia totals in the second half of the year. All of the signs seem favorable. Maybe, like the nation, it is most likely that the last six months will progress much like the first six months.



THIRD FEDERAL RESERVE DISTRICT

FOR THE RECORD...





SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	May 1957 from		5 mos. 1957 from year ago	May 1957 from		5 mos. 1957 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production	0	−4	−4	−1	+1	+2
Coal mining	+4	−1	−3	−1	−2	−3
EMPLOYMENT AND INCOME						
Factory employment (Total)	0	0	0	−1	0	0
Factory wage income	0	+1	+1	...	...	...
TRADE**						
Department store sales	+2	+2	+2	+2	+2	+2
Department store stocks	−3	+5	...	−1	+4	...
BANKING (All member banks)						
Deposits	−2	+3	+3	−1	+3	+2
Loans	+1	+5	+6	0	+6	+8
Investments	+1	+2	−1	0	−1	−4
U.S. Govt. securities	0	+3	0	−1	−1	−4
Other	+1	−1	−2	+1	+1	−2
Check payments	+9†	+5†	+3†	+2	+6	+7
PRICES						
Wholesale	...	...	...	0	+2	+4
Consumer	0‡	+3‡	+4‡	0	+4	+4

**Adjusted for seasonal variation.

†20 Cities
‡Philadelphia

LOCAL CHANGES	Factory*				Department Store				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change May 1957 from		Per cent change May 1957 from		Per cent change May 1957 from		Per cent change May 1957 from		Per cent change May 1957 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Allentown	−1	−2	−1	+6	...	...	...	...	+ 4	+4
Harrisburg	0	+4	−3	+8	...	...	...	...	+ 7	+4
Lancaster	0	−2	−2	+2	+24	+ 2	−4	+ 3	+ 1	+6
Philadelphia	0	+1	0	+5	+ 2	+ 1	−2	+ 6	+11	+4
Reading	+1	−4	+3	−1	+ 7	+15	−2	+19	+20	+7
Scranton	−1	−1	−1	+3	+ 7	0	−2	− 1	+ 1	−1
Trenton	+2	−2	+4	+2	+ 2	+ 4	−4	+ 5	+16	+5
Wilkes-Barre	−2	+1	−2	+6	− 4	− 2	−1	+ 3	+ 6	+5
Wilmington	0	+2	−3	+5	+ 1	+ 7	−4	+10	− 8	+8
York	−2	−6	−1	−4	− 2	+ 2	−4	− 4	+ 4	+1

*Not restricted to corporate limits of cities but covers areas of one or more counties.